Supreme Court, U.S.
FILED

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No. 99 209 JUL 26 1999

# In The
# Supreme Court of the United States
## October Term, 1998

BRIAN PATRICK AND
WAYNE PATRICK,
*Petitioners,*

v.

COMMISSIONER OF INTERNAL REVENUE,
*Respondent.*

**Petition For A Writ Of Certiorari To The United States Court of Appeals For The Sixth Circuit**

## PETITION FOR WRIT OF CERTIORARI
**with Appendix**

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## QUESTIONS PRESENTED FOR REVIEW

1. Whether funds received by Petitioners from the Qualified Profit-Sharing Plan were loans from the Plan or distributions taxable to Petitioners?

2. Whether Petitioners, respectively, are entitled to exclude the amount of $50,000 in funds received from the Qualified Profit-Sharing Plan from their taxable income for tax year 1992 pursuant to I.R.C. § 72(p)(2)?

## LIST OF THE PARTIES TO THE PROCEEDINGS IN THE COURT BELOW

This proceeding in the Supreme Court of the United States involves a Petition for Writ of Certiorari to the

United States Court of Appeals for the Sixth Circuit, Civil Case Nos. 98-1487 and 98-1488. The parties are the Petitioners, Wayne Patrick and Brian Patrick. Attorney of record for Petitioners is Brian H. Rolfe.

The Respondent is the Commissioner of Internal Revenue, through its counsel Steven W. Parks and Teresa E. McLaughlin.

The Sixth Circuit Court of Appeals affirmed, in a per curiam opinion, the judgment of the United States Tax Court which found that funds received by Petitioners from the Qualified Profit Sharing Plan were distributions, and not loans from the Plan, thus includable in Petitioners' taxable income.

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The Per Curiam Opinion of the United States Court of Appeals for the Sixth Circuit appears at Appendix A to the Petition and is dated April 30, 1999.

The Opinion of the United States Tax Court appears at Appendix B to the Petition and is dated January 26, 1998.

The trial transcript from the Tax Court proceedings of these consolidated matters is attached as Appendix C.

## BASIS OF JURISDICTION

The judgment of the Court of Appeals (App. A-1) was entered on April 30, 1999. The jurisdiction of

this Court is invoked pursuant to 28 U.S.C. 1254(1).

## CONSTITUTIONAL PROVISIONS, TREATIES, STATUTES, RULES AND REGULATIONS INVOLVED

Two sections of the Internal Revenue Code relating to loans treated as distribution are involved: 26 U.S.C. 72(p) (App. D-1), 26 U.S.C. 72(t)(App. D-2).

## STATEMENT OF THE CASE

This case involves the issue of whether funds received by Petitioners from the Erie Industries Inc. [hereinafter "Erie"], Qualified Profit-Sharing Plan [hereinafter the "Plan"] were in the form of loans, a portion of which to be excluded from Petitioners'

taxable income, or distributions from the Plan thus fully includable in Petitioners' taxable income. The subsumed issue then becomes whether Petitioners, respectively, can exclude $50,000 of funds received by them from the Plan from their taxable income pursuant to I.R.C. § 72(p)(2).

Erie engages in precision machining and grinding (App. B pg. 3). During the time period at issue, Erie maintained a profit sharing plan for its employees (App. B pg. 3). The Plan was not drafted by Petitioners, but was set up by Petitioners' father and drafted by Petitioners' father's attorney in the 1960's.

During 1992, 1993, and 1994 Petitioner Brian J. Patrick [hereinafter "Brian"] was a participant in the

Plan and took loans from the plan (App. B pg. 5). In consideration for the loans, Brian executed promissory notes (App. B pg. 5). Brian, at the time he took the loans from the plan, intended to pay the loans back (App. B pg. 11), and in fact, he did pay a portion of the loans back to the plan (App. B pg. 15). Brian borrowed approximately, $205,300 from the Plan (App. B pg. 5).

During 1992, 1993, and 1994, Petitioner Wayne L. Patrick [hereinafter "Wayne"] was also a participant in the plan. Wayne took loans from the plan in the amount of $624,000 (App. B pg. 6). In consideration for receiving the funds, Wayne executed promissory notes and the terms of the notes required the payment of 10% interest, to be repaid over a five year period

(App. B pg. 6). Wayne has paid back a portion of the funds received App. B pg. 15).

The Tax Court found that the funds received by Petitioners were not in the form of loans, but were distributions from the plan, includable in Petitioners' respective taxable income (App. B pg. 16). The Tax Court made that finding even after acknowledging that both Petitioners gave uncontroverted testimony that their intention was to receive loans from the Plan, and that they at all times intended to pay the loans back (App. B pg. 11).

The Tax Court, dismissing the testimony of the Petitioners, relied upon the purported objective factors to establish that there was no bona file debt created, and thus no loan

made by the Plan in the instant case. Pursuant to the above reasoning the Tax Court did not exclude the first $50,000 received by Petitioners from the Plan, as is allowed by I.R.C. §72(p). The Sixth Circuit, which had jurisdiction pursuant to Fed. R. App. P. 13 and 14, affirmed the Tax Court decision in its Per Curiam Opinion. (App. A-1).

Both the Tax Court and the Sixth Circuit Court of Appeals refused to give any weight to Petitioners' testimony and the authority which favors Petitioners' contention that the amounts borrowed were in the form of loans from the Plan.

The Tax Court and Sixth Circuit Court of Appeals also refused to exclude $50,000 from Petitioners' taxable income, ignoring the fact that

Petitioners were at all times able to repay $50,000, the minimum amount excludable from taxable income pursuant to I.R.C. §72(p).

**REASON FOR GRANTING THE PETITION**

This case presents important questions relating to the characterization of funds borrowed from profit-sharing plans by insiders of small and closely held corporations when there is no breach of any fiduciary duty towards the company. There is conflict and confusion in the law in determining whether funds received from profit-sharing plans will be treated as loans or distributions for tax purposes. (See Appendix B) There is significant conflict in the Tax Court's reasoning. To wit: substan-

tially similar factual scenarios are treated in opposite fashions. Compare Fuller v. Commissioner, 40 T.C.M 1184 (1980), Geftman v. Commissioner, T.C. Memo. 1996-447 (quoting Haag v. Commissioner, 88 T.C. 604, 616 (1987), Berthold v. Commissioner, 404 F.2d 119, 122 (6th Cir. 1968), Livernois Trust v. Commissioner, 433 F.2d 879, 882 (6th Cir. 1970) to the holding of the Tax Court and Per Curiam Opinion of the Sixth Circuit Court of Appeals in the instant case.

Consequently, it appears that only this Court can remove the confusion in the reasoning addressing the issues presented in the instant case. Only this Court is in the position to present well defined parameters to evaluate credibility and character of funds received by insiders from prof-

it-sharing plans.

## ARGUMENT AND AUTHORITIES

### I. QUESTION 1 - DISTRIBUTION FROM THE PLAN AND BONA FIDE DEBT

In its Per Curiam Opinion (App. A-1; which adopted the reasoning and analysis of the Tax Court (App. B-1)) the Court of Appeals for the Sixth Circuit found that the funds received by Petitioners Brian Patrick and Wayne Patrick were not bona fide loan transactions; thus no valid indebtedness was created. As such, all funds, including the initial $50,000, received by Petitioners from the Plan were determined to be taxable as distributions from the Plan.

The determination of whether there is a valid indebtedness turns on a review of the "indicia of debt."

The parties intent, in that regard, is the crux of the issue and is dispositive evidence of the appropriate ultimate form of the transactions for income tax purposes. When intent is not clear from the evidence, some of the other factors considered by the Courts are:

1. Whether a note or other evidence of indebtedness exist. Clark v. Commissioner, 18 T.C. 780 (1952), aff's, 205 F.2d 352 (2nd Cir. 1953);

2. Whether interest is charged. Clark, supra;

3. Whether there is a fixed schedule of repayments. Clark, Supra;

4. Whether there is any security or collateral given. Zimmerman v. United states, 318 F.2d 611 (9th Cir. 1963);

5. Whether there is any written loan agreement. Road Materials, Inc., v.

Commissioner, 407 F.2d 1121 (4th Cir. 1969);

6. Whether the parties' records, if any, reflect the transaction as a loan. Montgomery v. United States, 23 F.Supp. 130 (Ct. Cl. 1938);

7. Whether any repayments have been made. Estate of Ames v. Commissioner, No. 1294 (T.C.M. 1946); See also, Dixie Dairies Corp. v. Commissioner, 74 T.C.M. 476, 496-497 (1980).

In Fuller v. Commissioner, 40 T.C.M. 1184 (1980) the following "indicia of debt" were established **specifically with regard to transfers from pensions and profit sharing plans**. Strong indications of whether the funds transferred were in the form of a loan were whether:

(1) The amounts were evidenced by

formal debt instruments in the form of notes, providing regular repayment terms and an interest rate that the parties consider to have been a good interest rate for loans .... The amounts of the payments were sufficient to pay off the debts and interest within the terms of the notes without requiring "balloon payments," if the original schedule of repayment is adhered to ....

(2) The notes were secured ....

(3) The notes were personally guaranteed by petitioners ....

(4) The transactions were treated as loans ....

(5) Monthly repayments on the promissory notes were made ....

(6) [Testimony] that the transactions were loans and that at all times . . . [the obligors] fully intended to repay

the resulting debts.

(7) [T]rustee of the trusts ... was aware of the loans and did not object to them.

Fuller v. Commissioner, 40 T.C.M. 1194 (1980).

In Fuller, Petitioner Jack Fuller was engaged in the lumber business. On March 3, 1975, the Pension Trust of Fuller's company transferred $25,000 and $14,000 to Fuller. Fuller signed a promissory note with respect to each amount calling for interest and principal payments, and equal monthly payments for each. In addition, the promissory notes were secured.

The Commissioner of Internal Revenue contended the amounts received by Fuller from the Trusts in 1975 constituted taxable income to Peti-

tioners in 1975 as either distribution or discharge of indebtedness. Petitioners in Fuller, as here, contended that the transactions were at all times bona fide loans and therefore not taxable. The court balanced the indicia of loan with the indicia of distribution and found that the transfers were in fact loans.

The Fuller, court weighed the above factors and found that on balance the funds received by the petitioners should be characterized as loans. The Fuller court held:

"when we give close scrutiny to the transfers in the instant case, their proper characterization is far from clear. However, on balance we conclude that treating the transfers as loans by the Trusts is more consistent with the record before us then is treating

them as distributions from the Trusts." Id.

Applying the foregoing "indicia" to determine whether there was "valid indebtedness" establishes that in fact the funds received by Petitioners, in the instant case, were in the form of loans from the Plan. The Court of Appeals (incorporating the Tax Court analysis) did not rely upon or even address the holding of Fuller. The Court, correctly acknowledging that the indicia of debt inquiry is instructive for the Court's determination, held that the intent of the parties ultimately controls the determination of whether a bona fide debt was intended (App. B pg. 9).

Notwithstanding the foregoing acknowledgment, the Court erroneously

found that there was no direct evidence of petitioners' state of mind (App B pg. 10). That finding is contrary to all the evidence, as admitted to by the Tax Court when it found that Petitioners specifically testified that their intention in this case was to obtain loans from the plan, and that they fully intended to pay the loans back (App. B pg. 11).

Petitioners were able to establish that they at all times intended to pay back the funds they received from the Plan. The testimony from petitioner Brian Patrick was as follows:

Q: With respect to the profit-sharing plan, did you ever take any loans from the plan?

A: Yes.

Q: I've handed you what's been marked

as Joint Exhibit 23-W. Do you recognize those documents?

A: Yes.

Q: Can -- and those are promissory notes that you have signed?

A: Correct.

Q: And do those notes represent --

THE COURT: You are leading the witness, counsel.

Q: Why did you execute those promissory notes?

A: So that I could pay back the loans that I took from profit sharing.

Q: So those notes represent the loans that you took from the profit sharing plan?

A: Correct.

Q: Okay.

At the time you received the funds that are the subject of those promis-

sory notes, did you intend to pay those funds back?

A: Yes.

Q: And have you paid those funds back?

A: A little bit. (App. C pg. 13-14).

The testimony of Petitioner Brian Patrick and the documentary evidence presented at trial establishes that promissory notes were executed in consideration of the respective sums identified therein. Brian Patrick promised to pay to the order of the plan the principal sum of each of the respective notes, and interest was to be paid at the rate of 10% per year. The principal and interest payments were to be paid in equal monthly installments until the full amount of principal and interest was paid in full, or five years from the date of the execution of each respective

promissory note.

Clearly, assuming we need to go beyond the dispositive evidence regarding the intent of the parties as established by the Petitioners' testimony at trial, the foregoing establishes that the first three "indicia of indebtedness" of Fuller, have been established. With respect to the fourth indicia, Brian Patrick testified that he understood the funds were received as loans and treated them as such (App. C pg. 14). The Petitioner also testified that payments were made on the loans satisfying the fifth indicia of indebtedness (App. C pg. 14), and that at all times he intended to repay the loans (App. C pg. 14).

The foregoing facts and analysis are virtually identical for Petitioner

Wayne Patrick. His testimony and the documentary evidence in support show that, like Brian Patrick, he too intended to create a valid indebtedness and/or satisfied all the indicia of debt set forth in the Fuller case.

The Court of Appeals (relying upon the analysis of the Tax Court) failed to properly analyze the facts and circumstances of this case in light of the existing law. The Court was given a great opportunity to clarify this issue for future decisions. Instead, the Court has established erroneous precedent. See Garcia v. Commissioner, T.C. Memo. 1998-203 (1998) (citing Patrick v. Commissioner, T.C. Memo. 1998-30 for the holding that "generally" distributions from a profit-sharing plan are treated as distributions). The

holding of the Court of Appeals compounds the confusion on this area of the law and specifically the issue of the requisites of a bona fide debt.

This Honorable Court should grant this Petition for Writ of Certiorari to clarify and define this confused area of tax law.

**QUESTION II - WERE PETITIONERS ENTITLED TO EXCLUDE $50,000 FROM THEIR TAXABLE INCOME**

The Court of Appeals (by way of its incorporation of the Opinion of the Tax Court) erred in finding that Petitioners were not entitled to exclude the respective amounts of $50,000 from their taxable income pursuant to I.R.C. §72(p)(2).

According to I.R.C. §72(p)(2), paragraph 1, loans from pension plans are not includable in taxable income to the extent of $50,000 reduced by an amount in excess of (I) the highest outstanding balance of loans from the plan during the one year period ending on the day before the loan was made, over (II) the outstanding balance of loan from the plan on the date the loan was made.

The foregoing section applies because it is less than one half the present value of the nonforfietable accrued benefit of the plan. Specifically, I.R.C. §72 (p)(2)(A)(1) indicates that the rule of inclusion does not apply to the extent that the loan does not exceed the lesser of $50,000 (with the appropriate reductions) or 1/2 the value of the present value of

the accrued benefit. $50,000 is less than 1/2 Petitioners' accrued benefit. As such, this is the applicable loan value limitation amount.

Brian Patrick's first loan was taken on January 31, 1992. The amount of the loan was $110,000. In determining whether the $50,000 limitation is reduced, we must look to the year preceding the date of this loan ending on the day before the loan was taken. On January 30, 1992, Brian Patrick's loan balance was $0.00 for the preceding year. This amount, $0.00, then reduces the $50,000 limitation to the extent it exceeds the outstanding balance of loans from the Plan on the date on which such loan was made. The loan balance, as of the date of the loan at issue, including the date of

inquiry, was $190,000.

As such, the $0.00 amount does not exceed the outstanding loan balance as of the date of the loan was made. As such, for the tax year 1992, the $50,000 loan balance limitation is not reduced, and Petitioner Brian Patrick is entitled to an exclusion from taxable income in the amount of $50,000. The fact that additional loans were taken after the initial $50,000 was borrowed has no effect on Brian Patrick's ability to exclude the first $50,000 of loan balance. The code section, 72(p), does not look prospectively but only retroactively and reduces the future loan amount by the past loan balances.

The foregoing analysis is equally applicable to Wayne Patrick. On January 31, 1992, he took a loan from the

plan in the amount of $190,000. With respect to 1992, Wayne Patrick is entitled to an exclusion from taxable income in the amount of $50,000. The fact that loans were taken after this date has absolutely no impact upon his entitlement to said exclusion. As such, Wayne Patrick is absolutely entitled to exclude the first $50,000 of the amount of the initial loan he received from the plan from his taxable income for the tax year 1992.

Even if this Honorable Court was to determine, as was the basis of the Court of Appeals' and Tax Court's determination, that the Fuller case did not control because the taxpayers' net worth substantially exceeded the sum of the balances of the promissory notes, and therefore the taxpayers

demonstrated their ability to repay the obligation, this Honorable Court should still grant Petitioners' Petition for Writ of Certiorari. In the instant case, the obligation of Petitioners to repay up to $50,000 was not such that there was an inability to repay that amount. Petitioners had the financial wherewithal to pay the $50,000 loans back over five (5) years as required by the Internal Revenue Code. The Court of Appeals erroneously failed to find those facts. This Honorable Court should grant the Petitioner for Writ of Certiorari to clarify the existing law in this regard. The Per Curiam Opinion of the Court of Appeals directly conflicts with the unpublished opinion of Miller v. Commissioner, 95-1 U.S.T.C. (1994) (holding that notwithstanding the fact

that funds received from profit-sharing plan were held to be taxable distributions, they were only taxable to the extent exceeding the $50,000 ceiling); See also, Federated Graphics v. Commissioner, T.C. Memo 1992-347 (1992).

## CONCLUSION

Petitioners respectfully request that this Honorable Court grant their Petitioner for Writ of Certiorari for a final review of this case.

Respectfully submitted

by _____ 7/13/99

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NOT RECOMMENDED FOR PUBLICATION

**No. 98-1487/1488**

**UNITED STATES COURT OF APPEALS**
**FOR THE SIXTH CIRCUIT**

| | | |
|---|---|---|
| BRIAN PATRICK AND WAYNE PATRICK, *PETITIONERS-APPELLANTS*, | ) | ON APPEAL FROM THE DECISION OF UNITED STATES TAX COURT |
| v. | ) | |
| COMMISSIONER OF INTERNAL REVENUE *RESPONDENT-APPELLEE.* | ) | |

Before: **Merritt, Guy, and Daughtrey,** Circuit Judges.

**PER CURIAM.** Petitioners Wayne and Brian Patrick each received funds labeled as loans from the qualified profit-sharing plan of their closely-held corporation. The Commissioner of Internal Revenue found that the funds were distributions and therefore includable in their taxable incomes; the Commissioner assessed a deficiency and penalty for both. The Patricks contested the Commissioner's findings, and the cases were consolidated and heard by the tax court. The tax court agreed with the Commissioner's findings. On appeal, the Patricks claim that the tax court clearly erred in finding that the funds were distributions fully includable in taxable income.

Having studied the record on appeal and the briefs of the parties, we are not persuaded that the Tax Court erred in finding that the funds that the Patricks received from the plan were distributions rather than loans. Because the reasons why judgment should be entered for the Commissioner have been fully articulated by the Tax Court, the issuance of a detailed opinion by this court would be duplicative and would serve no useful purpose. Accordingly, we AFFIRM the judgment of the Tax Court upon the reasoning set out by that court in its Memorandum and Opinion filed January 26, 1998.

T.C. Memo. 1998-30

UNITED STATES TAX COURT

WAYNE L. PATRICK, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent,

BRIAN J. PATRICK, Petitioner v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket Nos. 26419-96, 26420-96.
Filed January 26, 1998.

Joseph Falcone and Brian H. Rolfe,
for petitioners.
Mark L. Hulse and Laurence D. Ziegler,
for respondent.

## MEMORANDUM FINDINGS OF FACT AND OPINION

**LARO, Judge:** On October 4, 1996, res-pondent issued separate notices of deficiency to Brian J. Patrick (Brian) and Wayne L. Patrick (Wayne) based on their failure to include in gross income the distributions from a qualified profit-sharing plan and on Wayne's failure to include in gross income the distributions from an individual retirement account (IRA). Respondent determined deficiencies and additions to tax as follows:

Wayne L. Patrick--docket No. 26419-96:

| Year | Deficiency | Additions to Tax Sec. 6651 (a)(1) | Sec. 6654 |
|---|---|---|---|
| 1992 | $221,831 | $55,458 | $9,679 |
| 1993 | 11,647 | 2,912 | 488 |
| 1994 | 9,248 | 2,312 | 476 |

Brian J. Patrick--docket No. 26420-96:

| Year | Deficiency | Additions to Tax Sec. 6651 (a)(1) | Sec. 6654 |
|---|---|---|---|
| 1992 | $53,128 | $13,157 | $2,294 |
| 1993 | 5,701 | 1,425 | 239 |
| 1994 | 7,421 | 1,855 | 382 |

Petitioners separately petitioned the Court on December 10, 1996, to redetermine respondent's determinations. On October 7, 1997, the cases were consolidated for trial, briefing, and opinion.

Following concessions, we must decide:

1. Whether the money each petitioner received from Erie Industries, Inc. Employees' Profit Sharing Plan (the Plan) is includable in his gross income. We hold that it is.

2. Whether the money Wayne received from his IRA is includable in his gross income for 1993 and 1994. We hold it is.

3. Whether petitioners are liable for the 10-percent additional tax determined by respondent under section 72 (t) We hold they are.

Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the years in issue. Rule references are to the Tax Court Rules of Practice and Procedure.

**FINDINGS OF FACT**

Some of the facts have been stipulated. The stipulations and the exhibits attached are incorporated herein by this reference, and the facts contained therein are so found. Petitioners resided in West Bloomfield, Michigan, when they petitioned the Court.

Before and during the years in issue, petitioners were the owners, operators, employees, and shareholders of Erie Industries, Inc. (Erie Industries). Erie Industries is a subchapter S corporation engaged in precision machining and grinding. At all times, petitioners were at least 10-percent shareholders in the corporation.

Erie Industries maintained the Plan, which was a defined-contribution profit-

sharing plan established to operate as a qualified plan described in section 401 (a). The Erie Industries, Inc. Employees' Profit Sharing Trust was formed under the Plan. Wayne was the Plan trustee, and Erie Industries was the Plan administrator. Petitioners participated in the Plan.

The summary plan description provides for discretionary loans made from the Plan to participants and beneficiaries.[1] According to section VIII of the summary plan description, a participant had to apply for a loan on forms provided by the Plan administrator. The Plan administrator would then decide whether a participant qualified for the loan and inform the trustee of this decision. The trustee would review the administrator's decision and make an independent decision on whether to approve the loan. Also, according to the summary plan description, Plan loan requirements included the following: (1)

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[1] At trial, petitioners submitted Exhibit 7-G entitled "Erie Industries, Inc. Employees' Profit Sharing Trust Summary Plan Description", and the Court allowed the exhibit into evidence as a summary plan description and not as a representative copy of the Plan itself. Petitioners failed to locate and produce a copy of the Plan.

Loans must be made available to all participants and their beneficiaries on a uniform and nondiscriminatory basis; (2) loans must be adequately secured, with up to one-half of a participant's vested account balance as security for the loan; (3) loans must bear a reasonable rate of interest; (4) loans must have a definite repayment period which provides for payments to be made not less frequently than quarterly, and for the loan to be amortized on a level basis over a reasonable period of time, not to exceed 5 years;[2] (5) loans must be limited by the rules of the Internal Revenue Code; and (6) total loans to any one participant must be limited to the lesser of $50,000, with some adjustment for outstanding balance of loans, or one-half of a participant's or beneficiary's vested account balance.[3] Failure to make payments when due under the terms of the loan agreement would result in a default, whereby the trustee had the authority to collect the balance of the loan through any reasonable action that included

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[2] The 5-year amortization period could be extended if the Joan was used to acquire a participant's principal residence.

[3] These requirements were intended to incorporate the loan requirements embodied in sec. 72(p)(2)(A), (B), and (C).

instituting a lawsuit, foreclosing on any security, or recharacterizing the loan as a deemed distribution.

As participants in the Plan, petitioners entered into a series of transactions with the Plan. During 1992, Brian received $207,300 from the Plan.[4] The following promissory notes were prepared to evidence the transfers of the underlying amounts:

| Date on Note | Amount of Note |
|---|---|
| 01/31/92 | $110,000 |
| 02/28/92 | 26,000 |
| 03/31/92 | 6,000 |
| 04/30/92 | 2,000 |
| 05/31/92 | 10,000 |
| 06/30/92 | 2,000 |
| 07/31/92 | 31,000 |
| 08/31/92 | 10,000 |
| 09/30/92 | 3,000 |
| 10/31/92 | 2,000 |
| 22/31/92 | 5,300 |
| Total | [1]207,300 |

[1] Respondent's notice of deficiency incorrectly identifies the total amount of the transfers as $205,300, and respondent's deficiency determination is based on that figure. Respondent does not seek an increase in the deficiency determination.

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[4] At that time, Brian had not attained either retirement age under the Plan or the age of 59-1/2. See sec. 72(t) (2).

Most, if not all, of the notes were prepared after the corresponding transfers, and the notes dated September 30, October 31, and December 31, 1992, were not signed. Brian did not report any income with respect to these transfers.

In 1992 and 1993, Wayne received $624,000 and $17,000, respectively, from the Plan.[5] The following promissory notes were prepared to evidence the transfers of the underlying amounts:

| Date on Note | Amount of Note |
|---|---|
| 01/31/92 | $190,000 |
| 02/28/92 | 15,000 |
| 03/31/92 | 66,000 |
| 04/30/92 | 75,000 |
| 05/31/92 | 115,000 |
| 06/30/92 | 10,000 |
| 07/31/92 | 73,000 |
| 08/31/92 | 35,000 |
| 10/31/92 | 35,000 |
| 12/32/92 | 10,000 |
| Total | $624,000 |
| | |
| 02/28/93 | 17,000 |

Most, if not all, of these notes were prepared after the corresponding transfers, and the May 31, 1992, note is

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[5] At that time, Wayne had not attained either retirement age under the Plan or the age of 59-1/2. See sec. 72(t) (2).

not signed. Wayne did not report any income with respect to these transfers.

Each of petitioners' promissory notes contains the following terms: Repayment of principal with interest from date of transfer at a rate of 10 percent per annum; and payment in equal monthly installments commencing approximately 1 month after the date of each transfer until the earlier of repayment of principal and interest in full or 5 years from the date of the transfer. As security for each transfer, petitioners pledged their respective vested account balances. The record does not disclose the amounts of these balances at any time that is relevant herein.

During 1993 and 1994, Wayne maintained an IRA with Merrill Lynch. He received $9,000 from this account in 1993 and $9,307 in 1994. He did not report any income with respect to these amounts.

**OPINION**

We must decide whether the funds received by petitioners from their retirement accounts are includable in their gross incomes. Petitioners argue that the transfers from the Plan are loans from the Plan and nontaxable to the

extent of $50,000 for each petitioner. Petitioners concede that the transfers over $50,000 to each of them are distributions and, as such, are income to the recipients. See sec. 72(p) (2) (A). Respondent argues that there were no bona fide loans between the Plan and petitioners, and that no part of the transfers qualifies as a nontaxable loan under section 72 (p) (2). In the alternative, respondent argues that even if the transfers were loans, the amounts received would still be deemed distributions under section 72(p) and, as such, income to petitioners. As to all issues, petitioners bear the burden of establishing that respondent's determinations are incorrect. Rule 142(a); Welch v. Helvering, 290 U.S. 111 (1933)

I. Distributions From the Plan and Bona Fide Debt

Section 402(a) provides that "any amount, actually distributed to any distributee by any employees' trust described in section 401(a) * * * shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72".[6]

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[6] The provision applies to distributions made after Dec. 31, 1992. For our purposes, the version of sec. 402(a) in

Section 72(p) (1) (A) generally provides that loans from a qualified employer plan to plan participants or beneficiaries are treated as taxable distributions. Section 72(p) (2) provides an exception, however, where the following requirements are met: (1) The loan does not exceed the lesser of the amount set forth in section 72(p) (2) (A) (i) or (ii); (2) the loan, by its terms, must be repaid within 5 years from the date of its inception or is made to finance the acquisition of a home which is the principal residence of the participant; and (3) the loan must have substantially level amortization with quarterly or more frequent payments required over the term of the loan. Section 72(p) (2) applies only to distributions that are intended to be loans.

Respondent argues that the transfers from the Plan were taxable distributions and not loans. In support, respondent cites the following factors: In all cases in which the notes were signed, the notes were signed well after the transfers were made; petitioners presented no evidence, other than copies of the notes, that the Plan, the Plan administrator, the Plan trustee, or petitioners maintained any

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effect for distributions made in 1992 was essentially the same.

records reflecting the transfers as loans; any repayments on the notes, if in fact made, were insignificant; there was at no time a demand for repayment and no steps were taken to enforce the notes; neither petitioner had the ability to repay the transferred funds; and the notes were between related parties and the form of the transaction should not be honored where it lacks economic reality. In response, petitioners argue that sufficient "indicia of debt" are present to justify characterizing the transfers as loans.

A transfer of money will be characterized as a loan for Federal income tax purposes where 'at the time the funds were transferred, [there was] an unconditional intention on the part of the transferee to repay the money, and an unconditional intention on the part of the transferor to secure payment.' Geftman v. Commissioner, T.C. Memo. 1996-447 (quoting Haag v. Commissioner, 88 T.C. 604, 616 (1987), affd. without published opinion 855 F.2d 855 (8th Cir. 1988)). In other words, the parties must intend to create bona fide debt. The intention of the parties "relates not so much to what the transaction is called, or even what form it takes as it does to an actual intent that money advanced will

be repaid." Berthold v. Commissioner, 404 F.2d 119, 122 (6th Cir. 1968), affg. T.C. Memo. 1967-102; see also Livernois Trust v. Commissioner, 433 F. 2d 879, 882 (6th Cir.1970), affg. T.C. Memo. 1969-111. However, because direct evidence of a taxpayer's state of mind is not generally available, courts have focused on certain objective factors to determine whether a bona fide loan exists: (1) The existence or nonexistence of a debt instrument; (2) provisions for security, interest payments, and a fixed repayment date; (3) whether the parties' records, if any, reflect the transaction as a loan; (4) the source of repayment and the ability to repay; (5) the relationship of the parties; (6) whether any repayments have been made; (7)whether a demand for repayment has been made; and (8) failure to pay on the due date or to seek a postponement. See Smith v. Commissioner 370 F.2d 178, 180 (6th Cir. 1966), affg. T.C. Memo. 1964-278; Haag v. Commissioner, supra at 616 n.6.

The above factors are not exclusive, and no one factor is dispositive. See John Kelley Co. v. Commissioner, 326 U.S. 521, 530 (1946); Smith v. Commissioner, supra. The factors are simply objective criteria helpful to the Court in analyzing all relevant facts and

circumstances. The ultimate question remains whether "there [was] a genuine intention to create a debt, with a reasonable expectation of repayment, arid did that intention comport with the economic reality of creating a debtor-creditor relationship". Litton Bus. Sys. Inc. v. Commissioner, 61 T.C. 367, 377 (1973). This is a factual issue, to be decided upon all the facts and circumstances in each case. Geftman v. Commissioner, supra. Petitioners must prove that a bona fide debt was created arid that the transfers were loans. Rule 142(a); Welch v. Helvering, supra.

Both Brian arid Wayne testified that it was their intention to obtain Plan loans. Such testimony is, however, overcome by other evidence and is therefore not controlling. See Livernois Trust v. Commissioner, supra. We now turn to the objective factors relevant to the instant case.

a. The Existence or Nonexistence of a Debt Instrument

The existence of a promissory note for each transfer of funds is evidence of debt. However, respondent argues that the existence of notes in this case is not strong evidence of the character of the transactions because the notes were

not signed on or around the time of the distributions. Petitioners argue that the presence of the notes is strong evidence of debt.

Brian testified that the notes were not prepared or signed contemporaneously with the receipt of funds. He was unsure of when he had signed the notes but believed it to be in either 1992 or 1993. Brian further stated that he signed the notes "at least a year" after the receipt of the funds. Wayne did not know exactly when he had signed the notes. Given this testimony and other evidence in the record, the mere presence of notes is assigned little weight unless supported by some other objective evidence showing the distributions to be loans, especially considering petitioners' relationship to Erie Industries and Wayne's position as Plan trustee. Additionally, Brian's failure to sign three of his notes and Wayne's failure to sign one of his notes weakens petitioners' position that the notes are strong evidence of debt. Under these circumstances, "form does not necessarily correspond to the intrinsic economic nature of the transaction". Fin Hay Realty Co. v. United States, 398 F.2d 694, 697 (3d Cir. 1968). This indicium offers no more than marginal support for the existence of debt.

b. Provisions for Security, Interest Payments, and a Fixed Repayment Date

The notes contain provisions for security, payment of principal and interest, and a fixed repayment schedule over a 5-year period. Respondent argues that the existence of these provisions is weak evidence of debt because the notes were not signed until after the distributions were received and the provisions were ignored by both the Plan trustee and the administrator.

Security, interest, and repayment arrangements are ordinarily important proofs of intent to treat the transaction as debt. Berthold v. Commissioner, supra at 122. However, the fact that the funds were distributed before the drafting and signing of the notes militates against assigning much weight to this indicium.[7] Accordingly, this indicium offers no more than marginal support for the existence of debt.

c. The Parties' Records

Respondent notes that petitioners provided no evidence, other than the notes, that the Plan, the Plan admini-

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[7] We also note that no steps were taken to enforce these provisions.

strator, the Plan trustee, or petitioners maintained any records reflecting the transfers as loans. The record is indeed void of any other evidence that the parties maintained records indicating that the transfers created debt. This indicium supports a finding that the transfers did not create bona fide debt.

d. The Source of Repayment and the Ability To Repay

Respondent argues that petitioners had no ability to repay the transfers, and this indicium of debt is thereby lacking. The monthly installments, including interest, for Brian's 1992 "loans" totaled $4,405.74. In 1992 through 1994, Brian received wages, additional income, and interest income totaling $14,307, $45,364, and $51,293, respectively. Brian testified that he was aware of the fact that the 1992 notes required monthly payments totaling approximately $52,000 a year. He also testified that he entered into the transactions knowing that his wages for 1992 were only $14,000. The monthly installments, including interest, for Wayne's 1992 and 1993 "loans" totaled $13,623.08. In 1992 through 1994, Wayne received wages, interest and dividend income totaling $13,439, $45,359, and $57,352, respectively. Petitioners'

inability, ab initio, to meet their contractual obligation to service these "loans" is evidence that petitioners had no intention of treating the transactions as bona fide debt. We also note that Wayne's testimony that his repayment of the "loans" was contingent on the future success of Erie Industries supports our finding that Wayne did not intend to treat the transfers as bona fide debt. This indicium supports a finding that the transactions did not create bona fide debt. Cf. Fuller v. Commission T. C. Memo. 1980-370 (taxpayers submitted evidence that their net worth substantially exceeded the sum of the balances on the promissory notes, and thereby demonstrated their ability to repay the obligation)

e. The Relationship of the Parties

Two facts color the transactions between petitioners and the Plan: (1) Petitioners' status as owners, operators, employees, and shareholders in Erie Industries; and (2) Wayne's position as the Plan's trustee. Where the nominal creditor-and debtor are controlled by the same party and the arm's-length dealing that characterizes the market is lacking, the substance of the transaction and not its form is controlling. Road Materials Inc. v. Commissioner 407 F.2d 1121, 1124

(4th Cir. 1969), affg. on this issue T.C. Memo. 1967-187. In determining whether the form of a transaction between closely related parties has substance, we should compare their actions with what would have occurred if the transaction had occurred between parties who were dealing at arm's length. Peck v. Commissioner, 904 F.2d 525 (9th Cir. 1990), affg. 90 T.C. 162 (1988); Maxwell v. Commissioner, 95 T.C. 107, 117 (1990).

We find that under the standards of parties dealing at arm's length, the transactions at issue were not bona fide loans. Among other things, an administrator, trustee, or other fiduciary of a plan dealing at arm's length with a participant would not have approved "loans" where the participant lacked any documented ability to meet payment obligations. Although the Plan's administrator was required by the Plan to authorize any loan, we find no such authorization during the subject years. Furthermore, Wayne testified that he never reviewed the Plan or supporting documents, even though he was the Plan's trustee. We are left to conclude that petitioners rubberstamped these transfers. This indicium supports a finding that the transfers did not create bona fide debt.

f. Whether Repayments Have Been Made

Respondent argues that any repayment made by petitioners is insignificant. Brian testified that in 1995 he repaid approximately $3,000. Wayne testified that he had repaid only "a few thousand dollars". He stated that he did not remember making any payments or when the alleged payments had been made. We are unpersuaded by this testimony, and neither petitioner presented any objective evidence that any payment had been made on the notes. This indicium supports a finding that the transfers did not create bona fide debt.

g. Demand for Repayment

Respondent points to the fact that no demand for repayment has been made as evidence that these transactions were not loans. The record supports a finding that no steps were taken to enforce the loans. Wayne was not aware of his duties as Plan trustee, and he took no steps to collect on either his or Brian's notes. Moreover, Wayne testified that he was not even aware of whether Brian was in default. This indicium supports a finding that there was no bona fide debt.

h. Failure To Pay or Seek a Postponement

Brian testified that he repaid "a little bit" of the transfers, "approximately $3,000". He further testified that he made no repayments in 1992, 1993, or 1994. Supposedly a small repayment was made in 1995, and then only after he became aware that there might be "a problem" with the "loans". Brian made no effort to seek a postponement of payment on the alleged liability. Wayne testified that he had repaid only "a few thousand dollars". He had no idea of when these repayments were made. Wayne also made no effort to seek a Postponement of payment on the alleged liability. This indicium supports a finding that there was no bona fide debt.

1. Conclusion

On the basis of our review of all relevant factors, we find that the 1992 and 1993 transfers from the Plan to petitioners were taxable distributions and not loans.

II. Distributions From Wayne's IRA

Respondent determined that Wayne received taxable distributions from his IRA during 1993 and 1994 in the amounts of $9,000 and $9,307, respectively. In his petition, Wayne contends that he did

not receive taxable premature distributions from his IRA. In his response to respondent's request for admissions, Wayne further contends that the funds received from the IRA were loans. Wayne did riot address this issue at trial or on brief.[8]

Under section 408 (d)(1), "any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee * * * in the manner provided under section 72." See also Campbell v. Commissioner, 108 T.C. 54 (1997). Generally, any amount distributed from an IRA is includable in the gross income of the recipient in the year in which the distribution is received. Sec. 408(d)(1); sec. 1.408-4(a) (1), Income Tax Regs. Because there is no evidence in

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[8] Wayne appears to have abandoned his untenable position that the funds were received in the form of loans. Unlike a loan from a qualified plan, a loan from an IRA to its owner is always a prohibited transaction (there is no exception for loans from an IRA to its beneficiary). Sec. 4975(d); Employee Retirement Income Security Act of 1974, Pub. L. 93-406, sec. 408(d), 88 Stat. 829, 885. If such a loan was made, the IRA would lose its exemption and all assets would be deemed distributed. Sec. 408(e) (1) and (2).

the record that Wayne made nondeductible contributions to his IRA, we find that his tax basis in the IRA was zero. Sec. 1.408-4(a) (2), Income Tax Regs.; see also sec. 72(e) (2) (B). Therefore, he is afforded no credit for any investment in the IRA within the meaning of section 72 (e) (3) (A) and (6). See also Vorwald v. Commissioner, T.C. Memo. 1997-15. The distributions are thereby allocated to, and included in, Wayne's gross income as follows: $9,000 for 1993 and $9,307 for 1994.

III. Section 72(t) -- Additional Tax

Respondent determined a 10-percent additional tax under section 72(t) for premature distributions made from a qualified retirement plan to petitioners. Section 72(t) imposes an additional tax on any amount received from a qualified retirement plan equal to 10 percent of the amount includable in gross income. For purposes of the 10-percent tax, a qualified retirement plan includes an IRA described under section 408(a). See sec. 4974 (c) (4). Several exceptions to the imposition of the additional tax are enumerated in section 72(t) (2). Petitioners presented neither evidence nor argument in support of the application of any of the exceptions. Therefore, we find that petitioners are liable for the

10-percent additional tax under section 72(t) as follows: Brian as to the entire 1992 Plan distributions; Wayne as to the entire 1992 and 1993 Plan distributions and as to the entire 1993 and 1994 IRA distributions.

We have considered all other arguments made by the parties and found them to be either irrelevant or without merit.

To reflect the foregoing,

Decisions will be entered for respondent.

**UNITED STATES TAX COURT**

**In the Matter of:**

| | | |
|---|---|---|
| BRIAN PATRICK AND WAYNE PATRICK, *Petitioners*, | ) | DOCKET Nos. 26419-96 |
| v. | ) | 26420-96 |
| COMMISSIONER OF INTERNAL REVENUE *Respondent*. | ) | |

U.S. Tax Court
Hearing Room
231 West Lafayette Street
Detroit, Michigan

Tuesday, October 7, 1997

The above-entitled matter came on for trial, pursuant to notice, at 9:34 a.m.

**BEFORE:**
**THE HONORABLE DAVID LARO, Judge**

APPEARANCES:
On behalf of The Petitioner:

JOSEPH FALCONE, Esquire
BRIAN H. ROLFE, Esquire
Falcone & Rolfe
3000 Town Center
Suite 2370
Southfield, Michigan 48075

On behalf of the Respondent:
MARK L. HULSE, Esquire
Office of District Counsel
Internal Revenue Service
1600 Stewart Avenue
Suite 601
Westbury, New York 11590

PROCEEDINGS

[9:34 a.m.]

THE CLERK: All rise.

You may be seated.

Recalling from page 15 of the docket --- of the calendar, Docket Number 26419-96 and consolidated dockets, Wayne L. Patrick and consolidated Petitioners.

Please state your appearances.

MR. ROLFE: Good morning, Your Honor, Brian Rolfe on behalf of the Petitioners.

MR. FALCONE: Joseph Falcone on behalf of the Petitioners, Your Honor.

THE COURT: Good morning.

MR. HULSE: Mark Hulse for Respondent. Good morning, Your Honor.

THE COURT: Good morning. Are we ready to proceed?

MR. HULSE: Yes, we are, Your Honor.

MR. ROLFE: Petitioners are, Your Honor.

THE COURT: Any housekeeping?

MR. HULSE: Well, Your Honor, the parties have entered a stipulation of facts and we would like to file it with the Court at this time.

THE COURT: You may do that.

MR. HULSE: It is an original and one copy wit attached Exhibits from 3-A through 23-W.

THE COURT: Thank you.

Mr. Rolfe, you are in agreement, sir?

MR. ROLFE: That's correct, Your Honor.

THE COURT: All right. The Court accepts the stipulation of facts and makes them part of the record.

*[The Stipulation of Facts and the attached exhibits 1-A through 23-W were received into evidence.]*

THE COURT: Any other preliminary matters?

MR. HULSE: Not by Respondent, Your Honor.

MR. ROLFE: Nothing, Your Honor.

THE COURT: All right, let's proceed. Petitioner may make an opening statement.

MR. ROLFE: Thank you, Your Honor.

Your Honor, the main issue in this case is whether funds received by the Petitioners from a profit sharing plan are in fact distributions from that plan or were loans pursuant. to promissory notes executed by the Petitioners. That's essentially the issue presented before the Court.

Just another preliminary matter, Your Honor, Petitioners will concede the 6651 (a) (1) penalties so those will not be at issue in this trial.

THE COURT: Very good, thank you.

For Respondent?

MR. HULSE: Yes, Your Honor. A very brief one.

Your Honor, the facts of this case are rather simple. Petitioners owned a family-owned business known as Erie Industries. Erie Industries maintained a profit-sharing plan and both Petitioners were members of the plan and participated in the plan.

During 1992, Petitioner Wayne Patrick received distributions from the plan in the amount of $624,000 and Petitioner Brian Patrick received distribution in -- a little over $205,000. As Petitioner counsel has stated, Petitioner has alleged these amounts are loans. Respondent disagrees with this position.

In addition, Your Honor, Petitioner Wayne Patrick maintained an IRA account during 1993 and 1994. He received distributions of 9,000 in 1993 and a little over 9,300 in 1994. Once again, Petitioners allege that these are loans and once again Respondent disagrees with this position.

I think, Your Honor, Respondent thinks one of the important facts of this case is there are notes, Your Honor, there are notes for the transactions that took place between the Erie profit-sharing plan and the Petitioners but other than those notes, Your Honor, the

Respondent feels that there is no other evidence that these distributions were in fact loans and has treated them as taxable distributions.

THE COURT: All right, well, let me just as a couple quick questions. One, we are dealing with a profit-sharing plan. Is that what's here?

MR. HULSE: Yes, Your Honor, the Erie Industries profit-sharing plan.

THE COURT: Okay, and who trusteed the plan?

MR. HULSE: It is my understanding that Petitioner Wayne Patrick was trustee of the plan.

MR. ROLFE: I believe that's correct, Your Honor.

THE COURT: And does the plan contain provisions with respect to loans?

MR. HULSE: Yes, it does.

THE COURT: And you say there are notes?

MR. HULSE: There are notes, Your Honor, yes.

THE COURT: And do the notes comply with the terms and conditions of the plan loan provisions?

MR. HULSE: Yes, Your Honor. But there is one area that Respondent is unsure of, Your Honor, and that is the amount of the vested benefit that the Petitioners had in the plan at the time of the loan. But other than that, Your

Honor, it is Respondent's understanding that, yes, they complied with the provisions of the plan.

THE COURT: Okay, I just wanted to get a bird's eye view here, Thank you.

Mr. Rolfe, you may call your first witness.

MR. ROLFE: Thank you, Your Honor

At this time, Petitioners call Brian Patrick to the stand. Whereupon, a witness, was called for examination by counsel for the Petitioners and, having been first duly sworn, was examined and testified as follows:

THE CLERK: You may be seated, sir.

If you would, sir, please state your name for the record, spelling your last name, and your address.

THE WITNESS: **Brian J. Patrick**, P-a-t-r-i-c-k. Address is 7212 Cedar Bank Drive, West Bloomfield, Michigan.

THE CLERK: Thank you very much.

DIRECT EXAMINATION

BY ROLFE:

Q Good morning, Mr. Patrick.

A Good morning.

Q You are the Petitioner in this matter.

A Okay.

Q Okay. In 1992, '93 and 1994, who was your employer?

A Erie Industries.

Q And what type of business does Erie Industries engage in?
A Precision machining and grinding.
Q Okay. In those same years, 1992, '93 and 199&, were there other employees of Erie Industries?
A Yes.
Q If you recall, approximately how many employees were there?
A Twenty.
Q And during 1992, '93 and '94, did Erie Industries have a profit-sharing plan for its employees?
A Yes.
Q If you know, who drafted that plan?
A It was drafted back in the 1960s by an attorney, as far as I know.
Q Did you personally have any involvement in drafting --
A No.
Q -- the provisions of the plan?
A No.
Q Okay.
Did your father set up the plan?
A Yes, he did.
Q And so he would have been involved in drafting the particular provisions?
A I -- to my knowledge, yes.
Q Okay.
After the plan was set up and during your employment with Erie Industries, did you ever sit down and talk about any of the provisions of the plan with anyone?

A No.
Q You were not involved with any redrafting of the plan itself?
A No.
Q You obviously were a participant in the plan?
A Yes.
MR. ROLFE: Okay.
Your Honor, may I approach the witness?
THE COURT: You may.
BY MR. ROLFE:
Q I have handed you what's marked as exhibit - - Joint Exhibit 7-G which the parties have agreed to is a copy of the profit-sharing plan we're discussing. Have you ever seen that document before?
A Yes.
Q Okay. And are you familiar with the provisions of that particular document?
A No.
Q Okay. Have - - have you ever looked it over?
A No.
Q If you take a look at Section 8 of the plan, I believe it is page 14.
A Okay.
Q I will just give you a minute and you can take a look at that.
THE COURT: Well, why are you having him look at it? You don't have to look at it yet, sir.

MR. ROLFE: That is the provision dealing with loans.

THE COURT: But he says he is not familiar with it. He says he hasn't reviewed it. So why are you having him look at it now?

MR. ROLFE: I am having him look at it now because the Petitioner took loans from the plan.

THE COURT: All right.

MR. ROLFE: And I want to get into the loans a little bit themselves and identify to him that there is a provision in the plan dealing with loans.

THE COURT: He's never looked at it before? Sir, I said don't look at it.

THE WITNESS: Okay, sorry.

THE COURT: He says he hasn't reviewed it, he's not familiar with it.

MR. ROLFE: Okay.

THE COURT: And for him to read it now for the first time isn't going to be helpful to me. The document speaks for itself.

MR. ROLFE: That's fine, Your Honor.

THE COURT: By the way, I question whether 7-C is a copy of the plan. 7-C looks to me like it is a copy of the summary plan description, which is not the plan.

MR. ROLFE: Yes, Your Honor. I misspoke, myself. That's correct, it is a summary plan description.

THE COURT: And is there a copy of the plan?

MR. ROLFE: Not an exhibit, Your Honor, no.

THE COURT: Why not?

MR. HULSE: Your Honor, I think this is the only -- I don't think, to my knowledge, there is a copy of the plan. I know the - -

THE COURT: The plan doesn't exist?

MR. HULSE: No, Your Honor, the plan does exist but I don't know if there is a complete copy of the plan other than this document that describes the plan provisions, other than this; document.

THE COURT: This is not adequate for the Court. If the plan exists, I want it to be in evidence.

MR. HULSE: Well, Your Honor, I know we had subpoenaed a witness who, it is my understanding, is the keeper of these documents and it is my understanding that this is the best document that could be found regarding the plan.

Now, if possible, Your Honor, we could ask this witness to continue to look for it and keep the record open and to find it, submit it under a stipulation.

THE COURT: Let me understand. What you are saying is you subpoenaed it from the party; is that right?

MR. HULSE: Not from Petitioners,

Your Honor. From an accountant, it is my understanding, who is the accountant for the plan and who held some plan documents.

THE COURT: Well, let me ask Mr. Rolfe. Does Petitioner have a copy of the plan?

MR. ROLFE: I don't believe Petitioner does, Your Honor.

THE COURT: Do you know of any copy of the plan that exists?

MR. ROLFE: As Respondent's counsel indicated, the CPA may have a copy but, to my knowledge, I can't adequately tell the Court who would have a copy, Your Honor.

THE COURT: Okay. You may continue.

MR. ROLFE: Thank you.

MR. HULSE: Your Honor, Just to clarify, is the Court accepting 7-G as what it states, just a summary of the plan?

THE COURT: It is just a summary. It is a summary of various --

MR. HULSE: Provisions.

THE COURT: - - provisions in the plan. But this is not the plan and whether or not this summary is adequate will remain to be seen.

MR. HULSE: Okay, thank you.

THE COURT: You're welcome.

BY MR. ROLFE:

Q With respect to the profit-sharing plan, did you ever take any loans from the plan?
A Yes.
MR. ROLFE: May I approach the witness, Your Honor?
THE COURT: You may.
BY MR. ROLFE:
Q I've handed you what's been marked as Joint Exhibit 23-W. Do you recognize those documents?
A Yes.
Q Okay, and what are those?
A Promissory notes.
Q Can - - and those are promissory notes that you have signed?
A Correct.
Q And do those notes represent --
THE COURT: You are leading the witness, counsel.
BY MR. ROLFE:
Q Why did you execute those promissory notes?
A So I could pay back the loans that I took from profit sharing.
Q So those notes represent the loans that you took from the profit sharing plan?
A Correct.
Q Is that correct?
A Yes.

Q Okay.
At the time that you received the funds that are the subject of those promissory notes, did you intend to pay those funds back?
A Yes.
Q And have you paid those funds back?
A A little bit.
Q Today, do you still intend to pay back the balance of those promissory notes?

MR. HULSE: Objection. I believe he is still leading the witness?

THE COURT: Well, number one, you're leading. And number two, what he intends to do today is not relevant.

MR. ROLFE: Okay.

THE COURT: We're talking about the years '92 through '94.

BY MR. ROLFE: During those years at issue, 1992, 1993 and 1994, did you intend to pay the loans back?

MR. HULSE: Objection. I believe once again he is leading the witness, Your Honor.

THE COURT: Sustained.

THE WITNESS: Yes.

THE COURT: I will strike the answer.

THE WITNESS: Oh, sorry.

THE COURT: Once I sustain the objection, you don't answer the question.

THE WITNESS: I -- okay.

BY MR. ROLFE:

Q Have you paid the loans back?

A Approximately $3,000.

Q Were you aware of any requirements or limitations regarding the loans?

A Not at the time I took the loans, no.

Q Were you aware that there was a $50,000 --

MR. HULSE: Objection, Your Honor. Once again, I believe he is leading the witness.

THE COURT: Sustained?

BY MR. ROLFE:

Q You were not aware of any limitations?

THE COURT: Sustained. It is the same question.

BY MR. ROLFE:

Q How much money have-you borrowed from the plan? -

A Approximately $205,000.

Q Did you obtain advice about the loans, about taking loans from the plan?

A No.

Q Did you believe you could take the loans from the plan?

A Yes.

Q How much money have you borrowed?

A $200,000, basically.

Q And you thought that you were entitled to do that?

MR. HULSE: Objection, Your Honor.

THE COURT: Sustained.

BY MR. ROLFE:

Q At what point - - were you ever informed that there may be a problem with the loans?

A Yes.

Q When was that?

A Probably the end of 1993.

Q Okay.

What did you do when you heard there may be a problem?

A Basically nothing. I was kind of upset.

Q You were concerned?

A Yes.

Q Did you take any action?

A No.

Q Why not?

A Didn't know what to do. I didn't know what -- you know, if there was anything I was supposed to do.

Q Did you attempt to pay the loans back?

A Yes.

Q You indicated earlier you have not paid the loans

back?

A I paid a little bit, what I could.

Q And why haven't you paid the full amount back?

A Because I haven't had the funds to pay it.

MR. ROLFE: Okay, that's all I have.

THE COURT: Thank you.

You may cross-examine.

MR. HULSE: Yes, may I just have one minute, Your Honor?

THE COURT: Yes.

[Pause.]

CROSS EXAMINATION

BY MR. HULSE:

Q Mr. Patrick, do you still have Joint Exhibit 23-W?

A This?

Q Yes.

Mr. Patrick, if you would, please, turn to the last page of Joint Exhibit 23-W.

A Okay.

Q This is the promissory note, December 31, 1992?

A Yes.

Q I notice this is not - - this is not signed. Do you recall whether you signed this document on December 31, 1992?

A I signed all the documents that I was presented with, yes.

Q Do you have a copy of your original -- a copy of this document with the original signature on it?

A No, I don't.

Q Do you know where a copy of that document might be?

A The only place I could think would be my accountant.

Q That would be Mr. Scollin?
A Yes.
Q Mr. Scollin, was he the keeper of records for the plant?
A Not at that -- in 1992, no.
Q Mr. Patrick, when you entered into this note on December 31, 1992, you have -- you did not make any payments on the prior notes that you had entered into during 1992, have you?
A I'm -- I don't understand that.
Q In other words, when you entered this note on December 31, 1992?
A Okay.
Q Did you make any payments on any of the notes, on any of the notes you entered in 1992, at this time on December 31, 1992?
A No, it was at a later date.
Q So all the payments that you made, approximately $3,000, were made after 1992?
A Correct.
Q And they were made after 1994, too, correct?
A 1995.
Q Now, Mr. Patrick, you testified on direct that you did not read the plan; is that correct?
A Yes
Q How were you aware that you were able to take a loan if you did not read the plan?

A I really don't know.
Q Mr. Patrick, did you ever do a calculation, did you ever add up your monthly payments that were due under these notes?
A Yes, I did.
Q And since you did, were you aware that the payment of these notes came to approximately $52,000 a year?
A Yes.
Q And you are aware that we stipulated, the parties stipulated in 1992 your wages totaled $14,000 a year; is that correct?
A Yes.
Q So during 1992, your wages were $14,000 and yet you entered into these notes knowing that you had a yearly payment of $52,000?
A Yes.
Q You were vice president of Erie Industries at this time?
A Yes.
Q And you are aware of its daily operations?
A Yes.
Q You are aware of the amount of money Erie Industries was taking in per month?
A Yes.
Q And you were also aware of the amount of expenses Erie Industries had?
A Yes.

Q Mr. Patrick did you request -- did you seek approval when you entered into these loans from anyone other than your brother?

A No.

Q And your brother was trustee of the plan; is that correct?

A Yes.

Q You claim that there were approximately 20 employees during 1992, 1993, 1994?

A At that time, yes. Maybe less.

Q And were you aware that the amount of money in the plan was for the employees who participated in the plan?

A Yes.

Q It was for their retirement?

A Yes.

MR. HULSE: If I could just have one minute, Your Honor? I'm just --

THE COURT: Let me ask you, Mr. Patrick - -

MR. HULSE: Nothing else, Your Honor.

THE COURT: All right, I have a couple of questions.

On this Exhibit 23-W, which are the notes themselves?

THE WITNESS: Yes.

THE COURT: When were these notes prepared, do you recall?

THE WITNESS: I believe in 1993 or 1992. I'm not. sure.

THE COURT: So you're not sure when they were prepared?

THE WITNESS: No, I wasn't.

THE COURT: Who prepared these notes?

THE WITNESS: I do not know that.

THE COURT: Did you?

THE WITNESS: Did I prepare them?

THE COURT: Yes.

THE WITNESS: No.

THE COURT: Do you know whether some professional person prepared them?

THE WITNESS: I believe an attorney prepared them.

THE COURT: How did they come about? You say you don't know who prepared them. How did they come about?

THE WITNESS: I was given to them to sign.

THE COURT: And you were given them by whom?

THE WITNESS: Well, by my secretary, but where they came from, I think they came from my accountant.

THE COURT: So your best memory - -

THE WITNESS: My best memory is I got these from my accountant to sign.

THE COURT: Your accountant gave these to you and you were requested to sign?

THE WITNESS: Correct.

THE COURT: Did you sign these after you had already borrowed the money? You already had the funds, didn't you?

THE WITNESS: Yes.

THE COURT: How much alter you already had the funds did you sign the notes, do you recall? Was it a matter of weeks, months, years?

THE WITNESS: It was probably I'd say at least a year.

THE COURT: So a year after you already had the money, then you signed the note?

THE WITNESS: Right, after the -- the -- you know, the money that, was counted for the profit sharing plan, that's when I signed the notes.

THE COURT: Okay, thank you. Any questions?

MR. HULSE: I may have additional questions, depending.

MR. ROLFE: I have nothing further.

MR. HULSE: Your Honor, Just a few questions.

THE COURT: You may.

BY MR. HULSE:

Q I just want to make sure I understood you, Mr. Patrick. You say you signed these notes during 1993? A Yes.

Q Not 1992?

A Correct. As far as I know.

MR. ROLFE: Nothing further from me, Your Honor.

THE COURT: You may step down, sir.

*[Witness excused.]*

MR. ROLFE: At this time, Your

Honor, I would call Wayne Patrick to the stand. Whereupon,

**WAYNE L. PATRICK,**

a witness, was called for examination by counsel for the Petitioners arid, having been first duly sworn, was examined and testified as follows:

THE CLERK: You may be seated, sir.

If you would for the record, sir, please state your name spelling your last and your current address.

THE WITNESS: Wayne L. Patrick, P-a-t-r-i-c-k. My address is 2863 Chestnut Run, Bloomfield, Michigan 48302.

THE CLERK: Thank you very much, sir.

DIRECT EXAMINATION

BY MR. ROLFE:

Q In 1992, 1993 and 1994, were you an employee of Erie Industries?

A Yes.

Q During that time period did Erie Industries have a profit-sharing plan?

A Yes.

Q And were you a participant?

A Yes.

Q Okay, did you set up that plan?

A No, sir.

Q On redrafts of the plan, did you take part in those redrafts?

A No, sir.

Q Okay.
Who was the administrator of the plan?
A When?
Q During 1992, '93 and '94.
A I'm not sure I understand the question.
I mean, what was the administrator?
Q Well, did you administer the plan yourself? Did you oversee the plan?
A Not really.
Q Who did that?
A Well, we have -- had an accountant at the time, and an attorney. The attorney was always making amendments to the plan as Congress passed different laws and --
Q Okay, and did you ever take part in those amendments?
A No.
Q No. Have you seen the summary plan description? Have you ever reviewed that?
A No, I haven't.
Q You have not. Okay.
A I mean, I've seen it, like to throw it in the safe, but I've never read it.
Q Never read it. Never got into the provisions in particular?
A No, sir.
Q Did you take a loan from the profit-sharing plan?
A Yes.
Q Okay.

MR. ROLFE: May I approach, Your Honor?

THE COURT: You may.

THE WITNESS: Am I supposed to look at it?

THE COURT: Not yet. Just keep it in front of you.

BY MR. ROLFE:

Q I have handed you Joint Exhibit 10-J and 11-K. Do you recognize those exhibits?

THE COURT: You may look at them now, Just to see if you recognize them.

THE WITNESS: Yes.

BY MR. ROLFE:

Q Okay, and what are those exhibits?

A These are promissory notes signed by me.

Q That's right, and why did you sign those notes?

A Well, I borrowed the money from the plan and intended to pay it back.

Q Okay, so those documents evidence your intent to pay back - -

MR. HULSE: Objection, Your Honor. He's testifying to the witness.

THE COURT: Sustained.

BY MR. ROLFE:

Q Just one more time, why did you sign the notes?

THE COURT: Well, he's already answered the question.

MR. ROLFE: Okay.

BY MR. ROLFE:

Q If you recall, at the time period at issue, 1992, '93 and '94, did you intend to pay the loans back?

MR. HULSE: I object Your Honor.

THE COURT: It's leading?

MR. HULSE: Yes, Your Honor.

THE COURT: Sustained.

BY MR. ROLFE:

Q You signed the notes yourself; is that correct?

THE COURT: Well, the notes speak for themselves. He has indicated he's signed it. That's been asked and answered.

MR. ROLFE: Okay.

BY MR. ROLFE:

Q Have you paid any amount back to the profit-sharing plan?

A I understand I have.

Q Do you know how much?

A Just a few thousand dollars, I believe.

Q Okay. Why haven't you paid it all back?

A I haven't had the money.

Q Do you now intend to pay it back?

MR. HULSE: I object, Your Honor.

THE COURT: Sustained.

MR. HULSE: Excuse me, Your Honor. The phone is ringing.

BY MR. ROLFE:

Q At some point, did you become aware

that there might be a problem with the loans?

A Yes.

Q How did you become aware of that?

A My accountant brought it to my attention. And/or my attorney, I'm not sure which.

Q Okay

A Probably the accountant. You know, saw it in the balance sheet.

Q What action did you take as a result of that?

A Probably at the time, nothing. I had been in and out of the hospital so much, I just hadn't gotten around to it.

Q You indicated you have paid some amount back?

A Yes, sir.

MR. ROLFE: That's all I have.

THE COURT: Thank you.

Respondent may cross-examine.

THE COURT: Mr. Rolfe, do you have a trial memorandum?

MR. ROLFE: Yes, Your Honor.

THE COURT: For some reason I don't-

MR. ROLFE: It should have--yeah, it was mailed out--

THE COURT: Do you have an extra copy. I don't seem to have one.

MR. ROLFE: Okay. Let me take a look here.

THE COURT: I just don't seem to have a copy.

Oh, wait, I beg your pardon. I have one in the case of Wayne Patrick. How about in the case of Brian Patrick?

MR. ROLFE: It was submitted, Your Honor, yes. I'll see if I have an extra copy.

THE COURT: All right, if you have an extra copy, it'll be helpful.

You may proceed.

MR. HULSE: Thank you, Your Honor.

CROSS EXAMINATION

BY MR. HULSE:

Q Mr. Patrick, during 1992, '93, and '94 you were president of Erie Industries?

A Yes, sir.

Q And in 1992 you were 30-percent shareholder with your brother and your father?

A I don't know the percentage, but --

Q And do you recall that in '93 and '94 that you were a 50-percent shareholder with your brother?

A If you say so. I really don't recall at the time.

Q I guess what I'm getting at, you were aware of the day-to-day operations of Erie Industries?

A When I was there, yes. Like I said, I was convalescing for quite a while.

Q Now, Mr. Patrick, I'm looking at Joint Exhibit 10-J, which are these promissory notes.

A Okay.
Q Did you sign these in 1992?
A I really don't know.
Q Is it possible you signed them in 1993?
A You know, if I had to guess, I would say after the accountant did the - -
MR. ROLFE: Your Honor, I wouldn't like him to guess.
THE COURT: Oh, yes. I would agree. If you're guessing, don't.
THE WITNESS: I'm just not sure, sir.
BY MR. HULSE:
Q Now you testified on direct that you had made some payments. Those payments were made after 1990.
THE COURT: Well, let's go back to the question.
MR. HULSE: Okay. Sorry.
THE COURT: The question is, can you recall at all as to when you signed the note. Can you recall the year when you may have signed the note?
THE WITNESS: I'd have to guess.
THE COURT: I don't want you to guess.
THE WITNESS: Okay. No, I can't, sir.
THE COURT: Okay.
THE WITNESS: With all honesty.

THE COURT: Did you sign the note after the date in which you received the money that you borrowed from the plan?

THE WITNESS: I would say after the first -- the first loan, it was after that one.

THE COURT: All right.

THE WITNESS: Whether I did in between the other ones I'm just not sure.

THE COURT: All right. So you borrowed the money from the plan, and then sometime- after that you signed the first note.

THE WITNESS: Yes, sir --

THE COURT: Okay.

THE WITNESS: Your Honor.

THE COURT: Would it have been a matter of days, weeks, month, or years do you think?

THE WITNESS: I would say months.

THE COURT: Months afterwards. Okay. Thank you.

BY MR. HULSE:

Q Mr. Patrick, once again I'm looking at 10-J. If you'd just go through the first like four pages, if you would, please -- scratch that, Your Honor, if I may.

The first page, the date of this note is January 31, '82; correct -- '92, '92.

A Yes.

Q And do you recall that you entered these notes approximately once a month every month for 1992?
A No, I don't recall that.
Q Now, Mr. Patrick, on direct you testified that you'd made some payments under these notes; is that correct?
A That's what I've been informed. I really don't remember making them, but I believe I have.
Q But none of those payments were made in 1992; correct:
A I have no idea.
Q Is it possible they were made after 1994?
A I don't think so.
Q Now, Mr. Patrick, you were trustee of the plan; correct?
A Yes, sir.
Q Did you discuss these promissory notes with anyone?
A Like, I mean - -
Q Did you discuss it with any plan participant other than your brother?
A Oh, people in the shop would ask me if they could borrow money, and I would, you know, I'd just tell 'em I didn't know. You know, if the -- a lot of them asked, and --
Q I think that's fine. That's fine.
A They never pursued it, so I - -
Q Thank you very much.
A I didn't.

Q Mr. Patrick, did you - -

THE COURT: Excuse me. When you said you told them that you didn't know, is that because you didn't know, or is it because you didn't want them to borrow the money?

THE WITNESS: I just told them I didn't know. You know, I told them I could find out for them.

THE COURT: When you said that you didn't know, had you made a loan yourself from the plan at that time, or was that at a different time?

THIS WITNESS: Oh, this goes back many years. In fact, these people probably retired since then or changed jobs. Oh, I know what, like a lot of people would change jobs and they wanted to know if they could get their money, and then the attorney said they had to wait a year or something like, you know, that sort of thing.

THE COURT: Okay. But when people said to you that they may want to borrow money, some people said they may want to borrow some money from the plan, is that what I heard you say?

THE WITNESS: I think so. I can't specifically remember, but I remember people bringing that up.

THE COURT: Okay. Now had you at that point in time borrowed money yourself from the plan?

THE WITNESS: I don't think so.

THE COURT: You would have borrowed money later?

THE WITNESS: Well, whatever the dates were that I borrowed it.

THE COURT: Well, I'm trying to figure out what point in time you had a conversation with other employees with respect to their interest in borrowing.

THE. WITNESS: Well, I don't know if they'd actually said they'd borrow, but they wanted to know when
they could get their money or how, and I'm sure somebody I might have said can you borrow, and I said I don't know when I was by the end of it.

THE COURT: Okay.

THE WITNESS: Could I explain something so people don't think I'm ridiculously stupid?

THE COURT: Sure.

THE WITNESS: My father and his partner, who passed away, began the plan, which was drafted by an attorney, and after my father's partner passed away, they made me a trustee, but I'd never read the thing, you know, it's a book about yea thick with a bunch of legal mumble-jumble.

THE COURT: Where is it?

THE WITNESS: I assume it's in my safe. I have a shop safe or whatever you want to call it.

THE COURT: So you believe you have possession of it.

THE WITNESS: Yes, unless the -- unless I gave it to the attorney where, you know, he updates the thing and - - but I'm almost positive it's in my safe.

THE COURT: Okay.

THE WITNESS: But there again I'm guessing. I haven't looked at it. But the plan does exist.

BY MR. HULSE:

Q Mr. Patrick, did you have an Opportunity to add up your monthly payments under these notes?

A Probably I did. I don't remember specifically doing it.

Q Do you recall that your monthly payments added to approximately $163,000 per year?

A No, I didn't -- or I don't.

Q You don't recall that figure?

A No, sir.

Q During 1992 you didn't make $163,000 a year, did you?

A No. I -- I'm sure I didn't.

Q When you - - when you took the money from the plan, when you received the money from the plan, did you realize that you were not going to have sufficient income to make payment on the notes?

A Ummm.

Q During 1992?

A I don't know. I assume as business

got better I'd pay back the money, but, you know, I can't pinpoint it back to then.

Q So repayment was contingent upon the - -

A Making money, yeah.

Q Was contingent upon the success of Erie Industries?

A Yeah, that was my employer. Yes.

MR. HULSE: May I have just one minute, Your Honor?

THE COURT: Yes. [Pause.]

BY MR. HULSE:

Q Mr. Patrick, for Joint Exhibit 10-J, which is the 1992 notes, and also Joint Exhibit 11-K, which is the note dated February 28, 1993.

A '93? Okay, okay.

Q Did you sign these notes at the same time?

A You mean like the same day?

Q Yes.

A I doubt it, but I have no idea.

Q You just don't recall the date you signed them?

A No, sir.

MR. HULSE: Nothing further, Your Honor.

MR. ROLFE: I have nothing, Your Honor.

THE COURT: Let me ask you a question, sir. Let's just take one of the notes, it doesn't really matter too much.

Do you have in front of you Exhibit 11-K, the promissory notes?

THE WITNESS: I'm looking for the --

THE COURT: Oh, that's all right. Do you have it?

THE WITNESS: Yeah, I got this whole thing.

THE COURT: It's a 1993 note, Mr. Patrick.

THE WITNESS: Oh, okay, that one on the top?

THE COURT: You have it. Okay. That calls for monthly payments of $361.30; is that right?

THE WITNESS: That's what it says; yes, sir.

THE COURT: Okay. Did you make each and every one of those payments as required by the note?

THE WITNESS: I doubt it.

THE COURT: Okay. So you were in default of the note?

THE WITNESS: I guess you could say that.

THE COURT: Okay.

THE WITNESS: In fact, I didn't even realize I had paid money back, but my accountant informed me that I have.

THE COURT: But were you in default of the note?

THE WITNESS: If I didn't make all the payments; yes.

THE COURT: Okay. Now your brother also signed a note -- it's your brother Brian, right?

THE WITNESS: Yes, sir.

THE COURT: He also signed a note, and I'm looking now at Exhibit 23-W, which also requires frequent installment-payments. Would it be so that to your knowledge that he also was in default of his note?

THE WITNESS: No, I --

THE COURT: You don't know whether he was in default?

THE WITNESS: -No, I don't.

THE COURT: Okay. You were the trustee of the plan, though?

THE WITNESS: Yes, sir.

THE COURT: Okay. Are you aware of what your responsibilities are as trustee of the plan?

THE WITNESS: Um, the main thing I was aware of that you weren't supposed to make, you know, like buy penny stocks and that sort of thing.

THE COURT: Ummm.

THE WITNESS: I was just kind of, you know, a broker.

THE COURT: You were kind of a token.

THE WITNESS: Yes, sir.

THE COURT: Okay. So you didn't -- as trustee of the plan you didn't take

any actions to enforce the collectability of these notes?

THE WITNESS: No.

THE COURT: Okay. Is there a reason why you didn't?

THE WITNESS: Well, it depends on the time frame.

Like I said, I'd been in and out of the hospital so much, it was the least of my concerns.

THE COURT: Okay. How are you feeling now?

THE WITNESS: Pretty good.

THE COURT: Good.

THE WITNESS: Although with all my chemo and all the other stuff.

THE COURT: Okay. Questions?

MR. ROLFE: Nothing, Your Honor.

THE COURT: Okay. Thank you.

MR. HULSE: No, Your Honor.

THE COURT: You may step down, sir.

THE WITNESS: Thank you.

THE COURT: You should hand that back to your counsel, please.

*[Witness excused.]*

MR. ROLFE: Your Honor, Petitioners rest.

THE COURT: Okay. Before I look to Respondent --well, let me do that now.

MR. HULSE: Your Honor -- could I just have one minute, Your Honor.

THE COURT: You may have a minute.

MR. HULSE: Your Honor, can I have

five minutes? Is that possible, to have five minutes? I'm sorry. Your Honor, by taking five minutes may quicken this trial substantially.

THE COURT: I'll make it even quicker for you. Let's take a recess and have counsel meet me in my chambers.

THE CLERK: All rise.

[Recess.]

THE COURT: Okay, I think we're back at Respondent.

MR. HULSE: Yes, Your Honor. Your Honor, Respondent's calling no witnesses.

THE COURT: Okay. Do you rest your case?

MR. HULSE: Yes, Your Honor. Just one housekeeping matter, Your Honor.

THE COURT: Yes.

MR. HULSE: The parties would like to amend -- verbally amend the stipulation of facts, specifically paragraph 15.

THE COURT: Okay.

MR. HULSE: To read attached hereto as Joint Exhibit 7-C is a copy of the summary plan description.

THE COURT: Okay. What did it say prior to that?

MR. HULSE: It is a copy of the plan.

THE COURT: Okay. Satisfactory, Mr. Rolfe?

MR. ROLFE: We're in agreement with that, Your Honor.

THE COURT: All right. Very good.

MR. HULSE: Your Honor, also we've discussed with the Petitioner a possibility of leaving the record open for some time to try to obtain a copy of the plan.

THE COURT: Yes.

MR. HULSE: Does the Court have an objection to that, Your Honor?

THE COURT: Yes. Anything further?

MR. ROLFE: Nothing further.

MR. HULSE: Nothing from Respondent, Your Honor.

THE COURT: All right. Well, in that event, the Petitioner having rested, the Respondent having rested, then the matter is ready for briefing instruction.

I'm going to provide these instructions pursuant to Rule 151 of the Tax Court Rules of Practice and Procedure except as I may modify them by this instruction.

First, there will be - - the briefs will be simultaneous briefs. They're going to be due 30 days from today's date, which is November 6, that you'll make your normal proposed findings of fact, and then you will make any argument of law that you would like to make in support of your case. The legal argument portion shall be no more than 15 pages in

length. That in addition to providing the brief in normal written format you should also provide a small hard disk using WordPerfect 6.1 or greater.

MR. FALCONE: Your Honor, we don't have WordPerfect in our office.

THE COURT: Okay. You might put it on any disk -- what do you have?

MR. FALCONE: Well, we still use WordStar.

THE COURT: Why don't you put it on WordStar and I'll see if we can convert it.

MR. FALCONE: You can convert it, I'm pretty sure.

THE COURT: Okay. Then 10 days from that date, which I'll ask the Clerk for--

THE CLERK: Which will be 11/16.

THE COURT: 11/16, I would ask that you provide the Court with a second brief with one purpose only, and that is to point out discrepancies in the proposed findings of fact of opposing counsel. It won't be necessary for you to provide any legal argument in that second brief, and if you could provide the same kind of a computer disk with respect to the second brief as you did the first, I would appreciate it.

Any questions?

MR. FALCONE: Your Honor, how long are they taking to do transcripts?

THE COURT: A normal transcript -- the reporter can -- say this for himself, but I believe that the normal transcript time period is 30 days, but by consulting with him I believe that you can get one quicker than that. You can get one as early as 10 days, I'm informed.

THE CLERK: Excuse me, 10 days, that falls on a Sunday, so the date will be 11/17. That would be the Monday. Excuse me.

THE COURT: Okay. Anything further, then?

MR. HULSE: No, Your Honor.

MR. ROLFE: Nothing further, Your Honor.

THE COURT: Thank you very much. Appreciate the courtesy, and that concludes this case. We'll take a couple of minute recess and then the Clerk will call the next case.

THE CLERK: All rise.

[Whereupon, at 10:40 a.m., the trial was concluded.]

UNITED STATES TAX COURT

CERTIFICATE OF TRANSCRIBER AND PROOFREADER

Case Docket No. 26419-96 26420-96

Case Name: WAYNE L. & BRIAN J. PATRICK.

We the undersigned, do hereby certify that the foregoing pages, numbers 1 through 44, inclusive, are the true, accurate and complete transcript prepared from the verbal recording made by electronic recording by the reporter, Jon Hundley, on Tuesday October 7, 1998 before the United States Tax Court at its session in Detroit, Michigan, in accordance with the applicable provisions of the current verbatim reporting contract of the Court, and have verified the accuracy of the transcript by comparing the typewritten transcript against the verbal recording.

Date: 10/20/97 Transcriber:
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Date: 10/20/97 Proofreader:
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(o) SPECIAL RULES FOR DISTRIBUTIONS FROM QUALIFIED PLANS TO WHICH EMPLOYEE MADE DEDUCTIBLE CONTRIBUTIONS.--

(1) TREATMENT OF CONTRIBUTIONS. --For purposes of this section and sections 402 and 403, notwithstanding section 414(h), any deductible employee contribution made to a qualified employer plan or government plan shall be treated as an amount contributed by the employer which is not includible in the gross income of the employee.

(2) [Repealed]

(3) AMOUNTS CONSTRUCTIVELY RECEIVED.--

(A) IN GENERAL.--For purposes or this subsection, rules similar to the rules provided by subsection (p) (other than the exception contained in paragraph (2) thereof shall apply.

(B) PURCHASE OF LIFE INSURANCE.--To the extent any amount of accumulated deductible employee contributions of an employee are applied to the purchase of life insurance contracts, such amount

shall be treated as distributed to the employee in the year so applied.

(4) SPECIAL RULE FOR TREATMENT OF ROLLOVER AMOUNTS.--For purposes of sections 402(c), 403(a)(4), and 408(d) (3) the Secretary shall prescribe regulations providing for such allocations of amounts attributable to accumulated deductible employee contributions, and for such other rules, as may be necessary to insure that such accumulated deductible employee contributions do not become eligible for additional tax benefits (or freed from limitations) through the use of rollover's.

(5) DEFINITIONS AND SPECIAL RULES.--For purposes of this subsection--

(A) DEDUCTIBLE EMPLOYEE CONTRIBUTIONS--The term deductible employee contributions' means any qualified voluntary employee contribution (as defined in section 219 (e)(2)) made after December 31, 1981. in a taxable year beginning after such date and made for a taxable year beginning before January 1, 1987, and allowable as a deduc-

tion under section 2 19(a) for such taxable year.

(B) ACCUMULATED DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.--The term "accumulated deductible employee contributions" means the deductible employee contributions--

(i) increased by the amount of income and gain allocable to such contributions, and

(ii) reduced by the sum of the amount of loss and expense allocable to such contributions and the amounts distributed with respect to the employee which are attributable to such contributions (or income or gain allocable to such contributions).

(C) QUALIFIED EMPLOYER PLAN.--The term 'qualified employer plan' has the meaning given to such term by subsection (p)(3)(A)(i).

(D) GOVERNMENT PLAN.--The term "government plan" has the meaning given such tern, by subsection (p)(3)(B).

(6) ORDERING RULES.--Unless the plan specifies otherwise, any distribution from such plan shall not be treated as being made from the accumulated deductible employee contributions until all other amounts to the credit of the employee have been distributed.

(p) LOANS TREATED AS DISTRIBUTIONS.--For purposes of this section--

(1) TREATMENT AS DISTRIBUTIONS.-

(A) LOANS.--If during any taxable year a participant or beneficiary receives (directly or indirectly) any amount as a loan from a qualified employer plan, such amount shall be treated as having been received by such individual as a distribution under such plan.

(B) ASSIGNMENTS OR PLEDGES.--If during any taxable year a participant or beneficiary assigns (or agrees to assign) or pledges (or agrees to pledge) any portion of his interest in a qualified employer plan, such portion shall be treated as having been received by such

individual as a loan from such plan.

(2) EXCEPTION FOR CERTAIN LOAN.--

(A) GENERAL RULE.--Paragraph (1) shall not apply to any loan to the extent that such loan (when added to the outstanding balance of all other loans from such plan whether made on, before, or after August 13, 1982). does not exceed the lesser of--

(i) $50,000, reduced by the excess (if any) of--

(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

(II) the outstanding balance of loans from the plan on the date on which such loan was made, or

(ii) the greater of (I) one-half of the present value at the nonforfeitable accrued benefit of the employee under the plan, or (II) $10,000.

For purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to

any accumulated deductible employee contributions (as defined in subsection (o)(5)(B)).

(B) REQUIREMENT THAT LOAN BE REPAYABLE WITHIN 5 YEARS.--

(i) IN GENERAL.--Subparagraph (A) shall not apply to any loan unless such loan, by its terms, is required to be repaid within 5 years.

(ii) EXCEPTION FOR HOME LOANS.--Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant.

(C) REQUIREMENT OF LEVEL AMORTIZATION. --Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan (with payments not less frequently than quarterly) is required, over the term of the loan.

(D) BELATED EMPLOYERS AND RELATED PLANS.--For purposes of this paragraph--

(i) the rules of subsections (b), (c), and (m) of section 414 shall apply, and

(ii) all plans of an employer (determined after the application of such subsections) shall be treated as 1 plan.

(3) DENIAL OF INTEREST DEDUCTIONS IN CERTAIN CASES.—

(A) IN GENERAL.--No deduction otherwise allowable under this chapter shall be allowed under this chapter for any interest paid or accrued on any loan to which paragraph (1) does not apply by reason of paragraph (2) during the period.

(B) PERIOD TO WHICH SUBPARAGRAPH (A) APPLIES.--For purposes of subparagraph (A), the period described in this subparagraph is the period--

(i) on or after the 1st day on which the individual to whom the loan is made is a key employee (as defined in section 416(i)), or

(ii) such loan is secured by amounts attributable to elective deferrals

described in subparagraph'(A) or (C) of section 402(g)(3).

(4) QUALIFIED EMPLOYER LOAN, ETC.--For purposes of this subsection--

(A) QUALIFIED EMPLOYER PLAN.--

(i) IN GENERAL--The term "qualified employer plan" means--

(I) a plan described in section 401(a) which includes a trust exempt from ta under section 501(a),

(II) an annuity plan described in section 403(a), and

(III) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

(ii) SPECIAL RULE--The term 'qualified employer plan" shall include any plan which was (or was determined to be) a qualified employer plan or a government plan.

(B) GOVERNMENT PLAN.--The term "government plan" means any plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing.

(5) SPECIAL RULES FOR LOANS. ETC., FROM CERTAIN CONTRACTS.--For purposes of this subsection, any amount received as a loan under a contract purchased under a qualified employer plan (and any assignment of pledge with respect to such a contract) shall be treated as a loan under such employer plan.